

ST 01-0024-PLR 06/26/2001 EXEMPT ORGANIZATIONS

Only organizations that are exclusively religious, educational, or charitable and certain cultural/arts or senior citizen recreational organizations qualify for the statutory exemption required to make tax-free purchases of tangible personal property for use or consumption. See 35 ILCS 120/2-5. This PLR rescinds a PLR issued October 1, 1998 (ST 98-0015). (This is a PLR.)

June 26, 2001

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see <http://www.revenue.state.il.us/legalinformation/regs/part1200>), is being sent to rescind a Private Letter Ruling previously sent to you on October 1, 1998. Please be advised that the Taxpayers' Bill of Rights extends specific rights to taxpayers. Section 4 (c) of the Taxpayers' Bill of Rights directs the Department to abate taxes and penalties assessed based upon erroneous written information or advice given by the Department. Consequently, you will not incur tax liability as a result of your reliance upon the specific provisions of our prior correspondence. However, upon your receipt of this Private Letter Ruling, the provisions of this Private Letter Ruling shall become binding.

The October 1, 1998 letter stated as follows:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter dated March 19, 1998 that was received in our office on April 7, 1998. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the enclosed copy of Section 1200.110 appears to be contained in your request.

In your letter, you have stated and made inquiry as follows:

The purpose of this letter is to request a private letter ruling from the Illinois Department of Revenue on the fact pattern described below.

The interested parties in this proposed transaction are AAA, BBB and ZZZ. ZZZ is interested in leasing agricultural processing equipment from AAA since other lending institutions with which ZZZ does business are at or near their legal lending limit for ZZZ. The tax period at issue is calendar year 1998 and all future years. None of the interested parties are currently under audit nor are there pending litigation with the Illinois Department of Revenue. To the best of the knowledge of the interested parties, the Department has not previously ruled on the same or a similar issue for the parties or their predecessors. Nor have the parties submitted

the same or similar issue to the Department at any time previous to this request.

AAA is a member bank of the XYZ . BBB, a service organization under 12 U.S.C. 2211, is also part of the XYZ . The XYZ is a nationwide financial cooperative that lends to agriculture and rural America. Congress created the System in 1916 to provide American agriculture with a dependable source of credit. This credit can be provided by the use of loans or leases. The Farm Credit Administration, a federal agency of the executive branch of the United States government, is delegated authority by Congress to regulate the System institutions and their activities.

AAA desires to participate in leases with BBB. As of September 30, 1997 AAA had a 6.36% ownership interest in BBB. BBB will purchase the equipment as agent for AAA . For regulatory purposes, BBB will be considered the lead lessor and participate 100% to AAA , however at no time will BBB obtain legal title to the equipment. The designation of BBB as lead lessor is necessary in order to comply with regulatory requirements concerning business origination authority within the System.

Title to the equipment will pass directly from the equipment dealer to AAA. BBB will completely handle the billing and servicing of the transaction. In addition, BBB has guaranteed a residual value to AAA based on an estimate of the fair market value of the equipment at the end of the lease term. This guarantee is only effective if the transaction runs the full lease term. If, for any reason, the lease is terminated early then the guarantee is void and all realized gains or losses will be for the account of AAA . BBB will charge AAA a fee for the above. It is intended that the proposed transaction would qualify as a true lease for federal income tax purposes. Under the Internal Revenue Code, AAA would be the owner of the equipment and would have rental income and asset depreciation as a result of the transaction. A copy of the proposed agreement between AAA and BBB is included.

Under 86 Illinois Administrative Code Section 130.220 'the sale of tangible personal property to a purchaser who will act as a lessor of such tangible personal property is a sale at retail and is subject to Retailers Occupation Tax'. As the end users of tangible personal property located in Illinois under true leases, the lessors incur Use Tax on the lessor's cost price of items purchased for rental purposes. Normally, the seller collects the Use Tax and applies it to its Retailers' Occupation Tax liability. Since the lessors are considered the end users, subject to Use Tax, no Retailers Occupation Tax is imposed upon the rental receipts and the lessees incur no tax liability for the rental charges.

Under 12 U.S.C. 2023, AAA is exempt from all federal and state taxes, except real property tax. In addition, AAA has received an exemption identification number ('E' number) from the Illinois Department of Revenue (see copy attached). Pursuant to this exemption, the Use Tax normally incurred at the sale at retail would be inapplicable.

Therefore, we believe that AAA can lease the property to ZZZ under the fact pattern detailed above without either taxpayer incurring a Retailer's Occupation Tax on the transaction and request your conclusion as to whether this analysis is correct. AAA knows of no contrary authorities to this conclusion.

If you have any questions or require further information please contact me.

The Department agrees that AAA can lease the property to ZZZ under the fact pattern you present without either AAA or ZZZ incurring a Retailers' Occupation Tax liability on the transaction. Although your letter stated that you were attaching a copy of an exemption identification number (an "E" number) issued by this Department, we received no such attachment. We have, however, checked Department records and have verified that the Department has issued you a valid exemption identification number pursuant to 86 Ill. Adm. Code 130.2085(a)(2).

Please be informed that the characterization of a lease for federal income tax purposes is not relevant for determination of liabilities under the Illinois sales/use tax laws.

We enclose a copy of 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation and Use Tax purposes. Lessors are subjected to a Use Tax on their cost price or acquisition value of tangible personal property which they use by leasing in Illinois. The only exception is automobiles rented for one year or less.

True leases for Use Tax purposes generally have no buy out provisions at the close of the leases. If buy out provisions do exist, they must be fair market value buy out options in order to maintain the character of the true leases. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See, 86 Ill. Adm. Code 130.220(a). As end users of tangible personal property located in Illinois, lessors incur Use Tax liability on their cost price of such property.

Under Section 130.2010(a), persons who purport to "lease" the use of property, but in fact sell such tangible personal property to nominal "lessees," are considered to be making conditional sales whose total receipts are subject to Retailers' Occupation Tax. Such would be the case when the agreements contain one dollar or other nominal purchase options.

AAA, in its status as a XYZ, has been granted an exemption identification number by the Department which exempts it from Use Tax on purchases made in furtherance of its organizational purposes. We conclude that AAA is the purchaser and user of the property for Use Tax purposes, and that the purchase of rental property by AAA under the fact pattern presented appears to constitute a purpose pursuant to 12 U.S.C. 2013. Accordingly, AAA can purchase the subject property without the sellers incurring Retailers' Occupation Tax liability.

I hope this information is helpful. If you have further questions, please feel free to contact the Department.

## **DEPARTMENT'S RESPONSE**

The above referenced letter is rescinded in its entirety, effective immediately. As you know, subsequent to the above letter the Department amended 86 Ill. Adm. Code 130.2085, the applicable regulation for the subject of your inquiry. Under the prior regulation, your organization was granted tax exemption identification number E-9980-8897. The Department has amended this regulation to comply with applicable Federal and Illinois law. Accordingly, AAA does not qualify for a tax exemption identification number and the Department will revoke this number under separate cover. Retailers who make sales of tangible personal property to XYZ such as your organization are subject to Retailers' Occupation Tax on their gross receipts. However, because of federal law, your organization does not incur Use Tax liability on the same transaction. Please refer to Section 130.2085(a). As a result, when you purchase rental equipment or other tangible personal property from Illinois retailers, either directly or through an agent, the retailer is subject to Retailers' Occupation Tax liability on such sales. We are providing the following explanation for the benefit of you and your suppliers.

Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Illinois Retailers' Occupation Tax Act (35 ILCS 120/1 et seq.) imposes a tax on Illinois retailers measured by a percentage of their gross receipts from sales for use or consumption. The Illinois Use Tax Act (35 ILCS 105/1 et seq.) imposes a tax on the purchaser by taxing the use of tangible personal property purchased from a retailer.

When a purchase is made from an Illinois retailer (a seller who accepts purchase orders in Illinois or who fills orders from an Illinois inventory), both taxes are applicable and are complementary. That is, the Illinois retailer incurs Retailers' Occupation Tax liability on gross receipts from the sale and reimburses himself by collecting the Use Tax from the customer and retaining it.

When an Illinois user purchases from an out-of-State seller (a seller who accepts purchase orders outside Illinois and who fills orders from an inventory located outside Illinois), no Retailers' Occupation Tax liability is involved because no Illinois retailer is involved. In this situation, only the purchaser's Use Tax liability is applicable and the only question is how it gets paid. If the purchase is made from an out-of-State seller who is registered to collect Illinois Use Tax, the tax is paid to that out-of-State seller who, in turn, remits it to the Illinois Department of Revenue. If the purchase is made from an out-of-State seller who is not registered to collect Illinois Use Tax, the Illinois purchaser would have to pay the tax directly to the Illinois Department of Revenue.

In Illinois, only governmental units, organizations which are exclusively charitable, religious or educational and certain cultural arts or senior citizen organizations qualify as sales tax exempt purchasers. Both the Retailers' Occupation Tax Act (which imposes the seller's sales tax liability) and the Use Tax Act (which imposes the purchaser's/user's sales tax liability) contain provisions which exempt sales to and purchases by these specified organizations. Consequently, when these exempt organizations purchase from Illinois retailers, both the seller and the purchasing organization are relieved of liability on the transaction. When these exempt organizations purchase from out-of-State sellers, no Use Tax is due.

This same situation does not exist with respect to XYZs. XYZs do not qualify as sales tax exempt purchasers under any provision of Illinois law. XYZs are exempt from Illinois Use Tax liability under 12 U.S.C. 2023 – a Federal statute. However, 12 U.S.C. 2023 does not relieve Illinois retailers of Retailers' Occupation Tax liability when they sell to XYZs. This means that Illinois retailers do incur

Retailers' Occupation Tax liability on sales of tangible personal property to XYZs. They cannot, however, reimburse themselves for that liability by collecting the complementary Use Tax.

As noted above, the result would be different if a XYZ made a purchase from an out-of-State seller instead of an Illinois retailer. Because only Illinois Use Tax liability is involved when an out-of-State Use Tax collector makes a sale to a XYZ located in Illinois, that out-of-State Use Tax collector need not collect or remit tax on that transaction.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at [www.revenue.state.il.us](http://www.revenue.state.il.us) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

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Associate Counsel

KWB:msk  
Enc.